In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 482

ROBERT S. GERSTELL AND ALICE R. GERSTELL,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

This case involves the type of transaction present in *Knetsch* v. *United States*, 364 U.S. 361. The taxpayer has conceded that *Knetsch* is controlling and requires denial of the interest deduction he claimed in the Tax Court. On appeal, his sole argument was that he was entitled to a deduction for his out-of-pocket expenditures on the theory that they were expenses incurred for the production of income or losses from a transaction entered into for profit. Such expenditures were characterized by this Court in *Knetsch* (p. 366) as the "fee for providing the facade * * * whereby the [taxpayers] sought to reduce their * * * taxes" in a transaction in which it was "patent

that there was nothing of substance to be realized * * * beyond a tax deduction."[1] The question here, therefore, is whether a transaction designed to realize an after-tax advantage is a transaction entered into for the production of income or for profit within the meaning of Sections 23 (a)(2) and (e)(2) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 23) and their successors in the 1954 Code, Sections 165 (a) and (c) and 212.

1. The decision below affirming the Tax Court's denial of the claimed deduction, is correct and in accord with *MacRae* v. *Commissioner*, 294 F. 2d 56 (C.A. 9th), certiorari denied, 368 U.S. 955. The only kind of expenses which are deductible under Section 23(a)(2) of the 1939 Code are those which are incurred in connection with a profit-seeking purpose. See e.g., *United States* v. *Gilmore*, 372 U.S. 39, 45. Similarly, a loss deduction under Section 23(e)(2) (and its successor in the 1954 Code) is allowable only for loss in a transaction entered into for profit. This means *taxable* profit. *Weir* v. *Commissioner*, 109 F. 2d 996 (C.A. 3d), certiorari denied, 310 U.S. 637. Tax consequences cannot be made to turn on a motive to avoid taxes. *Gregory* v. *Helvering*, 293 U.S. 465; *Commissioner* v. *Transport Trad. & Term. Corp.*, 176 F. 2d 570 (C.A. 2d), certiorari denied, 338 U.S. 955.

[1] In 1952 out-of-pocket expenditures of $44,920.83 were made in an effort to produce a tax saving of $57,449.10. In 1952 the out-of-pocket expenses were $45,055.18 for a tax saving of $78,845.50 and in 1953 were $58,033.07 for a tax saving of $92,122.67.

2. The taxpayer is incorrect in stating that the decision below is in conflict with *MacRae* v. *Commissioner, supra,* and *Becker* v. *Commissioner,* 277 F. 2d 146 (C.A. 2d). *MacRae* held that out-of-pocket expenditures are not deductible under Section 23(e)(2) of the 1939 Code because an attempt to create an artificial tax deduction is not a transaction entered into for profit. The conflict asserted by the taxpayer is with reference to a point decided in both of those cases but not previously raised in the present case and not decided by the courts below, *i.e.,* the effect of Section 117(g)(2) of the 1939 Code and its successor in the 1954 Code, Section 1234(a), which provide that a loss from the failure to exercise an option is to be considered a capital loss. No option is involved in the present case. The only justification the taxpayer gives for raising that point at this time (Pet. 13) is that, while he does not contend that his out-of-pocket expenditures are deductible as capital losses, this Court should nevertheless grant certiorari in order to determine "whether a deduction of some sort" is allowable. This is in marked contrast to the "now familiar rule" that a tax deduction "is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer." *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590, 593.

3. As an adjunct to the main issues of deductible expense or loss, the taxpayer poses the question (Pet. 2, 21–26) whether the Commissioner could properly deny him a deduction after having issued seven un-

published letter rulings to other taxpayers. The taxpayer's position in that connection is clearly without merit and this Court has denied certiorari in a case involving some of the same rulings. See *Weller* v. *Commissioner,* 270 F. 2d 294 (C.A. 3d), certiorari denied, 364 U.S. 908.

4. Contrary to the taxpayer's assertions (Pet. 14–28), no issue of broad administrative importance is presented here. While it may possibly be that a number of other similar cases are now pending in which a deduction for out-of-pocket expenditures is being sought as a consolation prize in a *Knetsch* type of situation, the lack of merit in contentions such as this taxpayer's seems too obvious to require review by this Court, at least in the absence of a conflict of decisions.

The petition for certiorari should be denied.

Respectfully submitted,

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